

Financial Strategy

Masterton District Council

Introduction





This financial strategy sets the overall direction for the Council’s finances over the next ten years. It outlines a similar approach to our financial management as described in the previous Long Term Plan. Our approach for prudent financial management includes:

- spreading the cost across today’s and tomorrow’s users (inter-generational equity)
- having capacity to fund our future capital expenditure programme
- responsibly managing our reserves and investments to meet the inter-generational equity principle
- growth funding the costs of growth

We prepare detailed plans every year and a 10-year plan and review of policies every three years. We produce summary versions of those plans for our community and ratepayers and we consult about what we plan to do. We report against those plans every year and our Annual Report is audited by Audit New Zealand.

The end-point focus of the financial strategy is to ‘maintain service delivery while ensuring financial sustainability’. To deliver our services we need to maintain and renew the assets they depend on. To that end, asset management plans have been prepared and are the basis for forecast renewal expenditure programmes.

The Council’s financial management responsibilities

PRUDENCE AND SUSTAINABILITY Council will manage its finances prudently and in a way that promotes the current and future interests of the community		
		
FINANCIAL STRATEGY The Council’s financial strategy informs and guides the assessment of funding and expenditure proposals		INFRASTRUCTURE STRATEGY
		
FUNDING AND FINANCIAL POLICIES Council adopts a set of funding and financial policies to provide predictability and certainty over the sources and level of funding		
		
BALANCED BUDGET REQUIREMENT Unless it’s prudent not to, operating revenues will be set at a level that meets operating expenditure		

This financial strategy includes the limits on rates, rate increases and borrowing and describes our ability to provide and maintain service levels within these limits. It also outlines the Council's policy on giving security for borrowing and financial investments.

This financial strategy is closely linked to the Council's Infrastructure Strategy. The Infrastructure Strategy details the capital and operational budgets and specific projects in the areas of transportation and roads, water supply, stormwater, wastewater and community facilities.

Overview

Last year the Council took the time to understand the likely impacts of the COVID-19 pandemic on our community and we adjusted our revenue collection from rates and fees to support our community's ability to rebound. While the impacts of COVID-19 are unprecedented and evolving (which creates uncertainty) we have seen that Masterton district's economic recovery has been positive. Some of this reflects the drivers of our economy, which is heavily influenced by the primary sector and less reliant on tourism. Council's revenue streams have been relatively unaffected and construction activity and consenting volumes are still increasing. We have based our forward planning on the assumption that our recovery will continue on this trajectory.

Our financial performance and position over the last 12 years has been dominated by infrastructure expenditure. Over the next ten years we have scheduled some high value construction projects to address areas of community well-being. The proposed new civic facility, delivering our town centre revamp and building more pensioner housing are all significant projects that increase the level of service to our community. We are funding the majority of these projects with new debt and we will be increasing rates to pay for that increased level of service.

We are looking to respond to the needs identified in our asset management plans and increase spending on our roading assets to maintain the current level of service. Water resilience is also a major driver for expenditure as we look at water storage, leaks, meters and sustainable urban drainage (such as rain gardens).

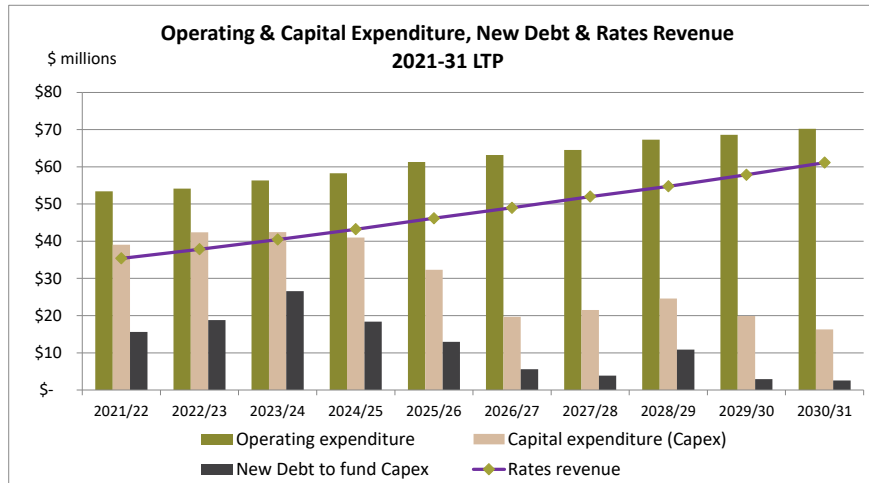
The level of net external debt is projected to increase from \$26.2 million to a maximum of \$93.6 million by Year 5.

Beyond 2031 significant investment in wastewater treatment, water and stormwater infrastructure is planned and we will be in a good position to be able fund this work from both depreciation reserves and debt.

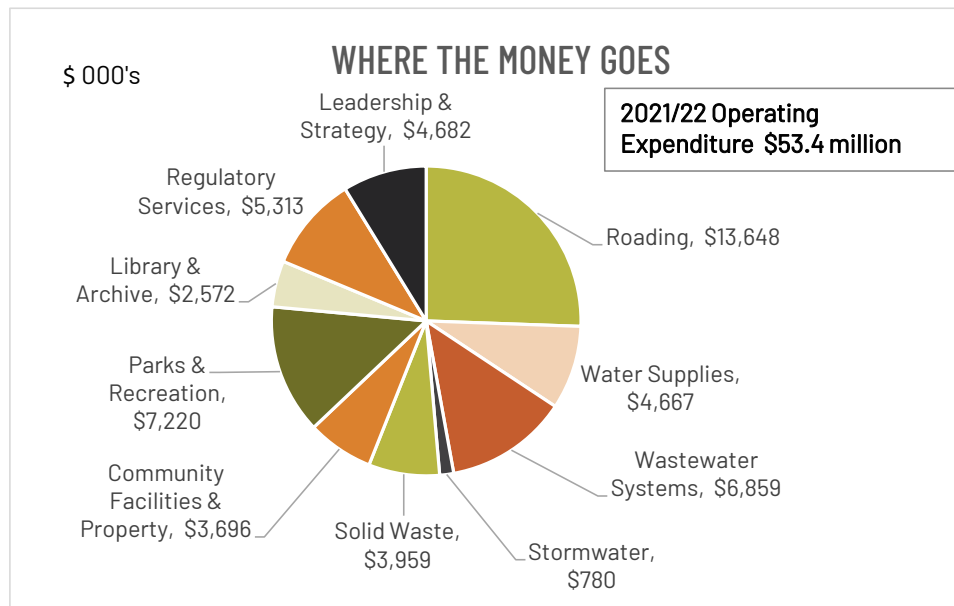
Rates increases beyond the limits in the last Long Term Plan (LTP) are required to fund the current and improved levels of service associated with the civic facility, housing and town revamp. In addition, the Council needs to catch up on the financial relief it provided to the community (through a reduced rates increase and lower fees) in 2020/21 in response to the impacts of the COVID-19 pandemic.

The proposed new limits are the Local Government Cost Index (LGCI) plus 4.5%, after growth. The previous LTP limit was LGCI plus 3.5%, after growth. Expenditure to be funded by rates is higher in the first five years of the plan so the Council has reduced this burden by smoothing the increases across the 10 years by utilising reserve funds in the early years and repaying them in the later years.

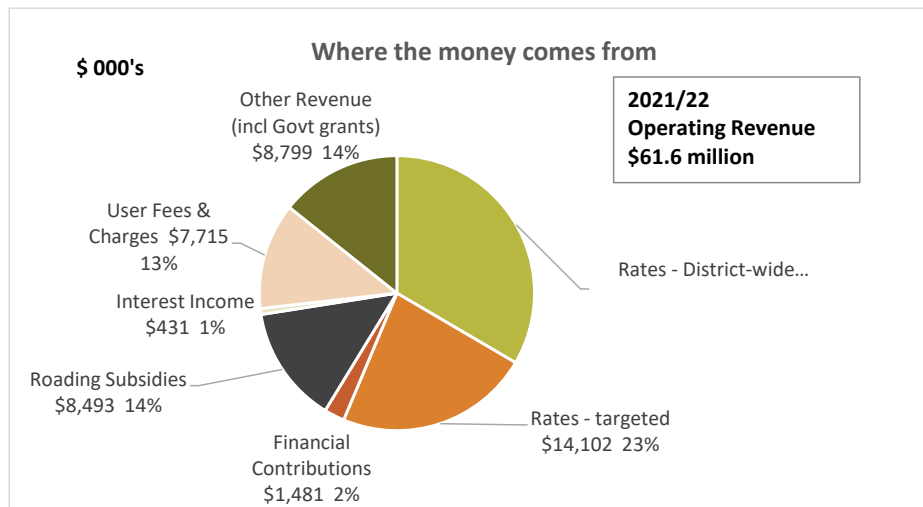
The graph below represents the financial picture of the forecast activity over the next 10 years. Some large capital projects are funded by new debt and the additional cost associated with those projects is the prime driver for the increasing rates required.



Where is the money spent?



Where does the money come from?



Our district

We expect to see population average annual growth of 1.01% per annum over the life of the plan which means Masterton district’s population will grow from 27,500 in 2020 to 30,549 (+11.1%) by 2031. Projections through to 2051 see the population increase to 32,153 (+14.5%) by 2051.

Our population will continue to age faster than the NZ average. Masterton currently has more people aged 65+ (21% compared to 15.2%); similar numbers of people aged under 15 (19.4% compared to 19.7%) and a smaller proportion of ‘working age’ (15-64 years - 59.6% compared to 65.1%). Our forecasting shows the Masterton population aged 65+ is expected to grow by approximately 73% between 2019 and 2051, from 5,825 to 10,100 people. Youth (under 15 years of age) and ‘working age’ groups are expected to remain at similar levels throughout this period. The combined effect is that the proportion of people aged 65+ will increase and Masterton’s population will age, projected to move from an average age of 42 in 2019 to 48 in 2051.

We are currently working to ensure we balance demand at both ends of the demographic pyramid, providing services and opportunities that engage and contribute to the wellbeing of both our younger and our more mature populations.

We are also becoming more diverse and we are reflecting this diversity in all that we do.

Household numbers are forecast to grow from 11,182 in 2020 to 12,718 in 2031 (+13.7%) and 13,794 by 2051 (+23.4%). This equates to average annual growth of 1.25% to 2031; and an average of 0.78% per annum to 2051.

Masterton has capacity for this level of forecast population and household growth within its key infrastructure and services and can accommodate housing growth up to 1.8% per annum over the next ten years.

Our services

We are planning to provide the same services at the same standard in most of our activities, but there are some areas (such as the urban water supply, the library, archives and civic facility, pensioner housing and town centre) where we are investing in assets and adding to operating costs. This investment will mean we need to collect more money (in the form of rates) over the period of the plan.

The proposed new civic facility, delivering our town centre revamp and building more pensioner housing are all significant projects that will increase the level of service to our community. We are funding the majority of these projects with new debt and we will be increasing rates to pay for that increased level of service. We will hold the rates increases below the limits defined in this strategy. We are responding to the needs identified in our asset management plans and increasing our spending on our water supply and roading assets to maintain the level of service delivered with those assets. Water resilience is also a major driver for expenditure with more water storage planned.

The Council is planning for regular and consistent renewal expenditure on roading, water, sewer and stormwater assets as well as 'business as usual' for all other Council services. We will keep debt below the borrowing limits defined in this strategy.

Water and Wastewater Infrastructure

Over the last 10 years our service to the community and the way we pay for it has been dominated by the capital expenditure and associated loan funding needed for the \$46 million upgrade of our wastewater treatment plant at Homebush. The completion of that project in 2015 and its subsequent successful operation have achieved greatly improved environmental outcomes. However, our work is not done. We are, therefore, planning to invest more to extend irrigation at Homebush and further reduce the environmental impacts of operating the plant to meet what we think will be tighter environmental standards when our resource consent expires. Our investment is nearly \$61 million (\$5 million in years 5 and 6 of this LTP for irrigation and a further \$45.3 million spread over five years from 2030).

We will therefore progressively repay the current debt relating to Homebush over the next 10 years to enable further borrowing from 2030 to make the changes we need to meet higher environmental standards.

The Council has taken a proactive approach to the renewal of water and wastewater pipes over the last nine years. Since 2009, some 22% of the sewer pipe network (30.2 km) and 13% of the water pipe network (21.4 km) have been renewed or relined. This has cost \$21.3 million and has been funded, in the main, by current revenue (from our depreciation reserves).

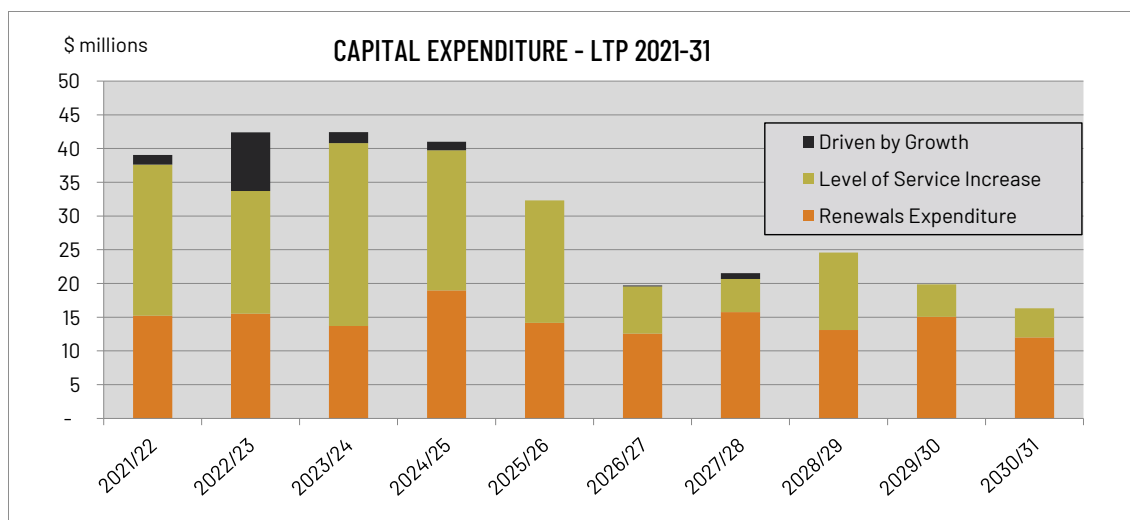
The Infrastructure Strategy indicates ongoing annual expenditure on renewal of our pipe networks. This financial strategy allows for those renewals be funded by money held in our depreciation reserves. Where planned capital renewals exceed the money in our depreciation reserve, the Council will borrow to fund the work. The extent of new debt required to fund these renewals programmes is included in the projection of debt shown in the graphs on the following pages.

In the last LTP the focus of our infrastructure investment moved to the Masterton urban water supply. The first major project is underway – the installation of water meters. Still on our work programme is building more water storage, renewing the Upper Plain trunk main, building an additional reservoir in Lansdowne and allowing for investment in water main renewals of between \$1.2 and \$1.6 million each year over the first seven years of the LTP. Expenditure at

this level is more than what we have available from our depreciation reserves, so an average of 25% of the renewal programme over those years is expected to be funded from additional debt.

Growing our Assets

Most capital expenditure over the next 10 years is driven by renewal of assets or increased levels of service from our assets. Where there is a need to invest because growth has caused additional demand, we will first use the financial contributions that we have collected from developers. These financial contributions are paid to councils under the requirements of the Wairarapa Combined District Plan.



Financial position

Council's debt

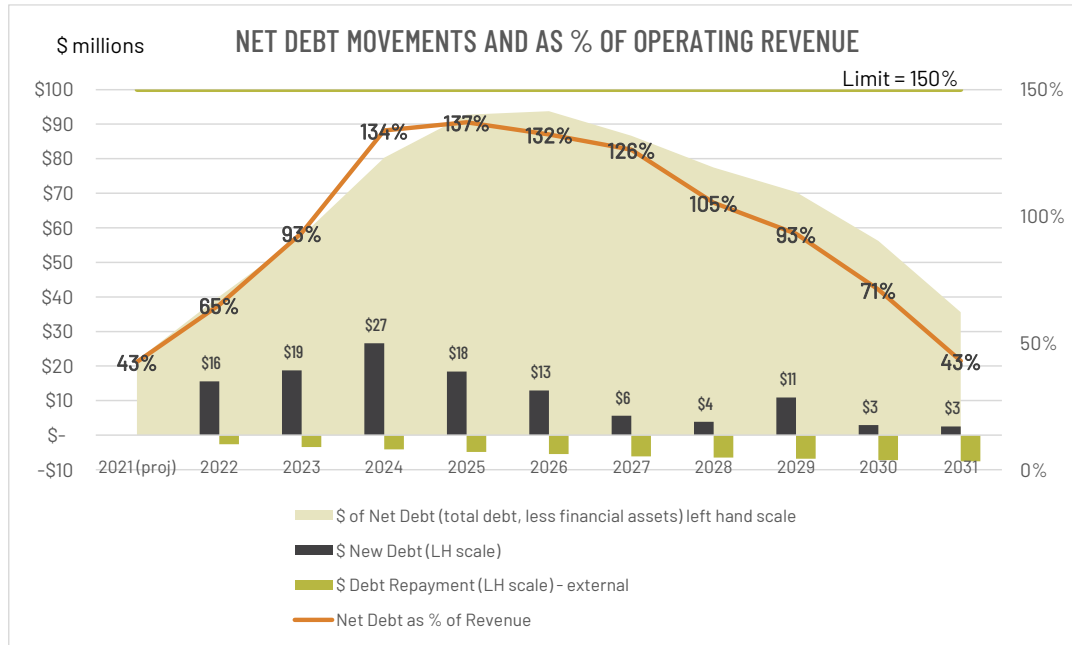
The level of external debt at 30 June 2021 is expected to be \$49.9 million. Net Debt (external debt offset by cash and financial assets) is expected to be \$21.7 million and will increase to \$93.7 million by 2026 before reducing to \$35.6 million by 2031 (see graph below under 'Debt Limits' section).

We are spreading the loan repayments on the Homebush debt over 25 years (the term of the consent). As described earlier, this will allow for further borrowing when additional investment is expected to be required in the early 2030s. Funding asset upgrades with debt allows the cost of to be borne by current and future ratepayers. We have set prudent policy limits on our borrowing to ensure our community is not over-indebted (see graph below under 'Debt Limits' section). We use interest rate risk management policies to protect against interest rate movements and provide a predictable cost of debt. We are assuming an average interest rate of 2.8%pa across the 10 years of the plan.

Our ability to borrow is based on our ability, via a Debenture Trust Deed, to offer rates revenue as security. We have invested in the NZ Local Government Funding Agency (LGFA) as a shareholding council and this enables us to borrow from them and take advantage of their access to favourable debt funding costs.

We are expecting little need for new infrastructure driven by growth in the district, however, where growth is expected to drive a need for investment, financial contributions are taken from developers. These are both general and specific to areas where the growth is driving the need for a specific piece of infrastructure. Our Financial Contributions Policy is based on

charging under the provisions of the Resource Management Act and the District Plan. The principle that ‘growth funds growth’ is one that up-coming revisions to the Wairarapa Combined District Plan (and the financial contributions set under it) will embed. We have assumed the level of contributions will remain constant under a new financial contributions scheme under a revised District Plan.



The charts on these pages show the net external debt increasing through to 2025, then reducing as loan repayments and financial assets increase. New debt and repayment of debt are separately budgeted and shown on the chart above.

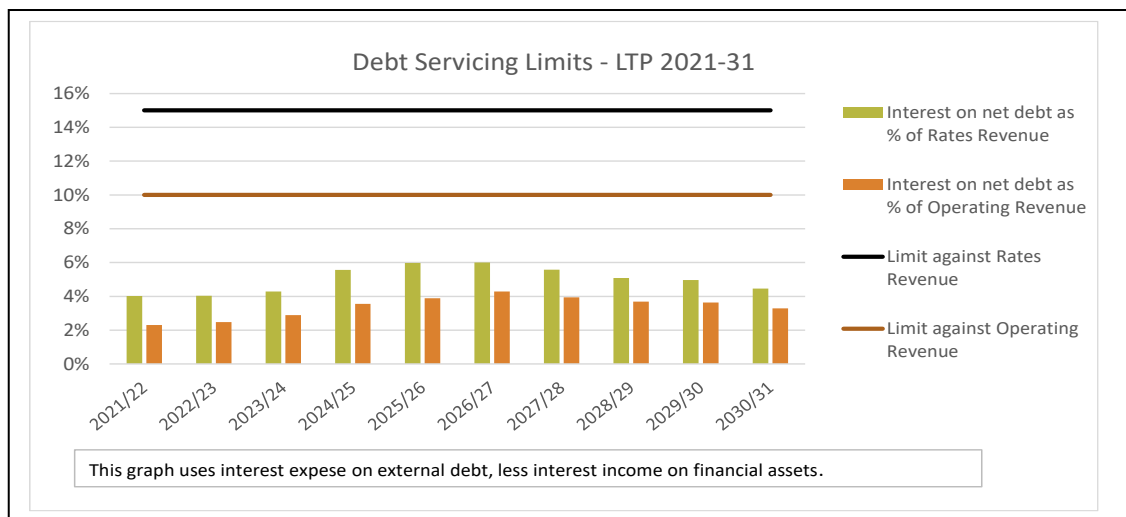
The limit of net debt being below 150% of Operating Revenue is considered prudent. There is room to borrow more and stay below the debt servicing limit.

If interest rates increase, the liability management policy of maintaining a prudent proportion of fixed interest (using hedging) protects against those movements.

Debt limits

The level of debt forecast over the next 10 years is represented in the previous graph, alongside the limit we have set as maintaining a prudent level of debt. We have also set a limit on how much debt servicing costs will be as a percentage of rates income and operating income. The limits are:

- Net debt not to exceed 150% of Operating Revenue
- Interest on external debt not to exceed 10% of Operating Revenue
- Interest on external debt not to exceed 15% of Rates Income



Reserve Funds and Investments

We have modest reserve funds built up from asset sales and depreciation on assets, which are expected to be \$30.2 million at 30 June 2021. The funds are invested in fixed interest instruments such as bond funds and term deposits and allow for internal borrowing/investment. The interest earned on funds invested is used to offset debt servicing costs for specific projects.

In the first five years of this LTP the roading and 3 waters reserve funds will be drawn down for renewals expenditure faster than they are replenished from depreciation, but not significantly. Across the balance of the 10 years there are projected funding surpluses that will build up the reserve fund balances. There is potential to repay debt earlier or utilise more internal borrowing but the LTP model assumes all debt required over the 10 years will be borrowed externally.

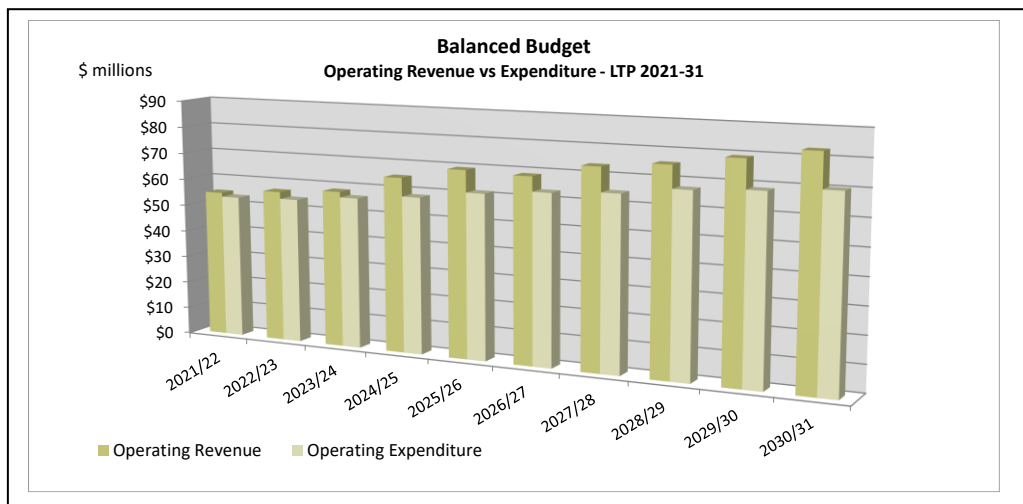
The Net Debt position takes account of cash funds building up in the later years of the LTP.

Financial investments are administered within the guidelines of the Treasury Management Policy. The primary objective of investing is the protection of the investment capital, with a prudent approach to risk and return. In preparing the LTP, the Council has assumed an average return on fixed interest investments of 2% in year 1 and 1.5% pa from 2022.

Depreciation and the balanced budget

We have achieved a 'balanced budget' as per the statutory requirement across the life of the LTP. The first five years of this LTP includes provision for grant funding coming from central Government and other sources as one-off revenue to fund capital expenditure. These include 3-waters stimulus funding, airport expansion funding and external grants for the civic facility. In the graph below, this one-off revenue has been excluded as it will distort the balanced budget position. Revenue from financial contributions is included.

Over the 10 years of the LTP, revaluations of assets have been allowed for. In general revaluations increase the value of the asset and this generates an increased need for funding of the depreciation associated with the asset. We have built in consistent increases in the funding of depreciation, except on assets we do not expect to replace, allowing us to consistently achieve a surplus budget and remain financially sustainable.

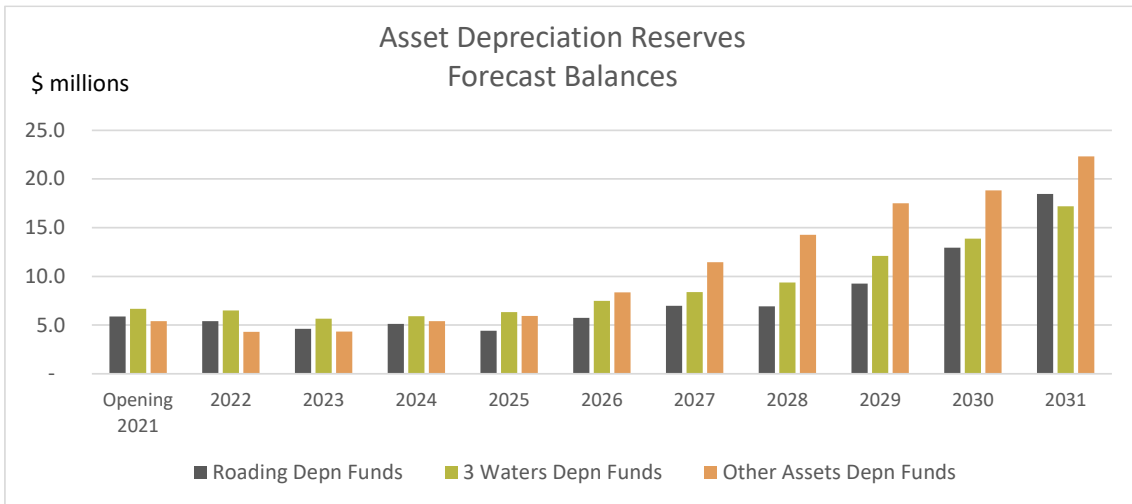


Full depreciation on Council assets has been recognised as an expense, but we have decided not to fully fund all depreciation on a number of specific assets (i.e. not fully allow for revenue to match the expense).

In the roading activity, as noted above, the renewals programme is designed to maintain the road network in a constant state. Depreciation expense is recognised and renewals are capitalised. The value of the capital programme is funded by way of subsidies from the NZTA and rates income. Those assets in the roading activity that are not renewed on an annual programme have funding from the depreciation reserve to cover our share (after the NZTA subsidy is received).

Other assets where the depreciation expense is not fully funded and the reasoning for each are as follows:

- Housing for the Elderly – to hold rents low and have no rates input, not all depreciation is covered by rental income. We have covered renewing components as required but full replacement of the homes at the end of their anticipated life will require external income assistance (e.g. government subsidies or more debt to be taken on). We have allowed to maintain and renew parts of the buildings appropriately, so we expect to extend the useful life of these assets and delay their replacement.
- Rural Halls – there is no intention to replace at least half of these buildings. This has been Council's policy for some time.
- Recreation Centre – the redevelopment of this facility in 2003/04 was half-funded with external contributions of approximately \$3.5 million. We are funding sufficient depreciation to cover replacement of plant and equipment. Not all depreciation is funded as we have assumed the future replacement of the facility will again attract external funding when it is required.
- Water, sewerage and stormwater assets – we have chosen to fund debt repayment directly from rates revenue in order to ensure the cost of upgrades is allocated and paid for by the ratepayers who benefit from those assets. Where loan repayments are funded by rates revenue, full depreciation from rates will not be funded as well.

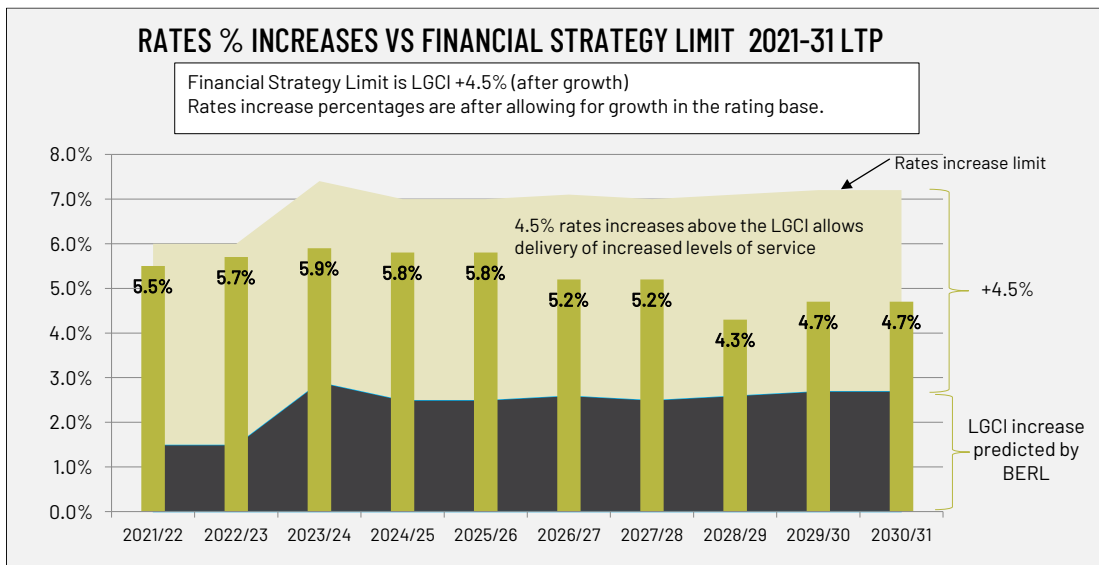


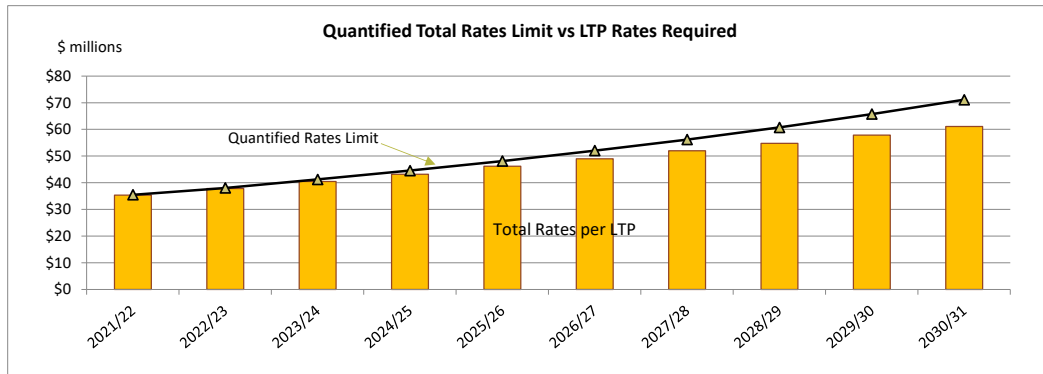
Rates increases

Rates revenue makes up approximately 68% of our operating revenue. Rates are levied on the property owners of the district and making affordable changes in the level of those rates is a key aspect of our decision making framework. There are many drivers for the need to increase our rates revenue by between 4% and 6% across the ten years of this LTP. In years 1-3 our roading programme has seen a step change in expenditure. In Years 2 - 5 the impact of the proposed investment in a new civic facility is a factor in the rates increases.

We have set a limit on how much rates revenue can increase – that limit is the LGCI movement plus 4.5%, plus growth in the rating base. For the year 2021-22 the LGCI is forecast to increase by 1.5%, so the Council is looking to stay below a 6.0% increase in its rates revenue. The LGCI is the rate of inflation of Council costs, calculated independently by Business and Economic Research Ltd (BERL).

Across the 10 years of the LTP, we believe we can hold the rates increases within the limit the Council has set. The number of properties that we can levy rates on and the capital values of those properties is predicted to grow annually over the course of the 10 years. We believe that growth will generate an additional 1.5% per annum of rates income in year 1, 1.25% in year 2 and 1% there-after. The extra revenue from this growth is taken up when comparing to the rates increase limits.





Risk and Resilience

Our financial resilience in the face of unexpected costs is based on having financial assets of at least \$15 million (and growing each year) to meet the initial costs of an event. Those funds are a mixture of term deposits and bond fund investments and are easily accessible if required. We carry material damage insurance cover on all buildings and significant above-ground assets. We also cover our underground network assets – the Council is a member of the Local Authority Protection Programme Fund (LAPP) which is designed to meet our obligation to pay 40% of the costs to restore our underground infrastructure in the event of a disaster. The balance of 60% is expected to be met by central Government’s Disaster Recovery Fund. Insurance products for our 40% of cover remain an option if the LAPP fund is not the most appropriate vehicle to cover MDC’s share of the risk.

Damage to roads and bridge assets in the event of a natural disaster (including flooding) will be funded by our annual roading budget, NZTA subsidies and our roading and flood damage reserve funds (which are part of the \$15 million noted above). We have assumed that the NZTA share of the costs will increase depending on the severity of the event.